Supreme Court of the United States

OCTOBER TERM, 1952

No. 51.

F. DONALD ARROWSMITH and RUTH R. BAUER, Executors of the Last Will and Testament of FREDERICK R. BAUER, Deceased, and RUTH BAUER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF AMICUS CURIAE

JOHN W. BURKE,
Amicus Curiae.

JUDICIAL PRINTING CO., INC., 82 Beekman St., N. Y.—BEekman 3-9084-5-6

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Opinions Below

The findings of fact and opinion of the Tax Court are reported in 15 T. C. 876 (R., pp. 4 to 8). The opinion of the Court of Appeals is reported in 193 Fed. (2d) 734 (R., pp. 19 and 20).

Jurisdiction

The opinion and judgment of the Court of Appeals were entered January 10, 1952 (R., pp. 19-21). A petition for rehearing was denied on February 11, 1952 (R., p. 24). The petition for writs of certiorari was filed on May 6, 1952 and was granted on June 9, 1952 (R., p. 25; 343 U. S. 976). Jurisdiction is conferred on this Court by Sec. 1254 of Title 28, United States Code.

Question Presented

Where a judgment against a dissolved corporation becomes final in 1944 and the former shareholders, as transferees, pay the judgment pro rata in 1944, the corporation having been dissolved and liquidated in the years 1937 through 1940, are the resultant losses capital losses?

Statement

The facts are set forth in pages 2 to 5 of petitioners' brief.

Summary of Argument

The judgment of the Court of Appeals now being reviewed held that the petitioners suffered a capital loss. This implies that the loss resulted from a sale or exchange. This is a question of fact which the Tax Court decided in favor of the petitioners herein, holding the loss was an ordinary loss. The Court of Appeals had no power to reverse this implicit finding of fact and nothing in the record supports the appellate court's finding. Policy considerations require that the Tax Court's determination be reinstated.

POINT I

The Court of Appeals erroneously made an implicit finding of fact contrary to the United States Tax Court.

Internal Revenue Code Section 117 (a) (5) defines a long term* capital loss as follows:

> "The term 'long-term capital loss' means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;"

When the Court of Appeals held that the 1944 losses were capital losses, it necessarily decided that they resulted "from" a sale or exchange. It is clear that there was no sale or exchange in 1944. It is also clear that there were a series of exchanges from 1937 to 1940 (whereby petitioners received assets for their stock). The only question then was whether the 1944 loss was "from" the earlier exchanges. In other words, should the 1944 payments be regarded as a separate transaction or as a part of an integrated transaction beginning in 1937. This Court has held that this is a question of fact for determination by the Tax Court. In *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), rehearing denied 321 U. S. 231 (1944), this Court said:

> "* * * Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences. Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact."

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* Short term capital losses are similarly defined except that the statute there refers to assets held for not more than 6 months, IRC Section 117 (a) (3).

Internal Revenue Code Section 1141 (a), as amended June 25, 1948, does not change this rule. Under Rule 52 of the Rules of Civil Procedure, the Court of Appeals may not substitute its judgment for that of the lower court in determining a question of fact. The appellate court can only reverse if the lower court's finding is "clearly erroneous".

POINT II

No facts support the decision of the Court of Appeals.

The 1944 payments can properly be regarded as adjustments to the 1940 liquidation exchange only if the 1940 liquidation was not a closed transaction.

This Court has already answered the basic question presented here, except that in the prior case the subsequent transaction involved a gain rather than a loss. In *Burnet* v. *Logan*, 283 U. S. 404 (1931), a taxpayer in 1916 had sold capital stock of an iron mine company for cash plus a royalty of all iron ore later mined. In later years taxpayer received these royalties as the ore was removed. The Commissioner claimed they were taxable to her as ordinary income. This Court held the payments were capital gain because the 1916 sale was not a closed transaction*, saying:

> "The consideration for the sale was $2,200,000 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. It had no ascertainable fair market value. *The transaction was not a closed one.*" (283 U. S. at 413, italics supplied.)

* Similar *facts* are required to keep a non-capital transaction "open" for the purpose of characterizing its consummation in a later year, see *Commissioner* v. *Smith*, 324 U. S. 177 (1945), at pages 181-2.

Thus the essence of the transaction was looking to the future. Even so this court relied on the fact of presently uncertainable value of the promised royalty to prevent the transaction from closing immediately.

Here, the essence of the earlier transaction was completion—liquidating and dissolving the corporation. Petitioners herein never agreed to pay Trounstine any amount to be fixed later. As the Tax Court pointed out, 15 T. C. at p. 878, the Trounstine claim was denied and actively resisted until 1944, four years after the liquidation was completed.

POINT III

The Tax Court's determination should be reinstated.

The rule which the Court of Appeals has asserted herein would keep every liquidation exchange open indefinitely. The only fact that Court relied on in reaching its decision is that the liabilities of the petitioners "would not have existed except for" the corporate liquidation, 193 Fed. 2d 734 at 735. In conflict with the workable rule of *Commissioner* v. *Switlik*, 184 Fed. 2d 299 (CA 3d, 1950), the respondent herein urges a rule which is first, dangerously impractical, and second, irrational.

It is dangerous because the same rule applied to gains is an invitation to widespread tax avoidance. Any corporation with assured prospects of substantial ordinary income could dissolve, and the shareholders would realize the income as capital gains which they "would not have received except for" the liquidation.*

* A recent volume contains the essay "How to Convert Ordinary Income to Capital Gain", Lasser, *Handbook of Tax Techniques*, Prentice Hall, 1951 (at page 788).

It is irrational because it adopts a *sine qua non* theory of proximate cause which is well known to be fallacious, as in tort cases.

We recognize clearly that the courts could prevent this theory from being carried to absurd extremes. But the prevention of abuse of this doctrine or of the contrary "Switlik" rule lies with the court which is to decide the facts in each case—here the United States Tax Court. That is the court Congress has designated to determine the facts and which can properly piece out a workable rule. Proper regard for good tax administration demands that the intermediate federal courts respect its function.

This Court has rightly stressed the importance of finality of the trial court's determination in this kind of problem. *Commissioner* v. *Culbertson*, 337 U. S. 733 (1949). The same method has been prescribed in *John Kelley Co.* v. *Commissioner*, 326 U. S. 521 (1946), and *U. S.* v. *Cumberland Public Service Co.*, 338 U. S. 451 (1950).

CONCLUSION

The United States Court of Appeals erred in reversing the Tax Court's determination because it implicitly substituted its contrary finding of fact without basis, in disregard of sound principles of judicial tax administration.

Respectfully submitted,

John W. Burke,
Amicus Curiae.

APPENDIX

Statutes and Regulations Involved

Internal Revenue Code

Sec. 117. Capital Gains and Losses.

(a) Definitions. * * *

(3) Short-Term Capital Loss.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

* * *

(5) Long-Term Capital Loss.—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months if and to the extent such loss is taken into account in computing net income;

* * *

Sec. 1141. Courts of Review.

(a) [As amended by Sec. 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869.] Jurisdiction—The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code.

Rules of Civil Procedure for the District Courts of the United States as Amended

Rule 52(a)—Findings by the Court.

Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * *

Consents Pursuant to Rule 27 (9)

We hereby consent, pursuant to Rule 27 (9), that the above *amicus curiae* brief may be filed in this proceeding with the Supreme Court of the United States.

GEORGE R. SHERRIFF,
Counsel for Petitioners.

ROBERT L. STERN,
Acting Solicitor General,
Counsel for Respondent.